

# Primer on Governance for Social Enterprises in Singapore

**Social Enterprise Association Ltd**  
9 Raffles Place #B1-05A  
Republic Plaza, Singapore 048619  
O: +65.6535.1883 | F: +65.6535.3822

[www.SEassociation.sg](http://www.SEassociation.sg)  
[info@SEassociation.sg](mailto:info@SEassociation.sg)



Mak Yuen Tuen, PhD, FCPA

# CONTENTS

<b>FOREWORD</b> .....	<b>1</b>
<b>1 OBJECTIVE OF PRIMER</b> .....	<b>3</b>
<b>2 GENERAL ISSUES</b> .....	<b>4</b>
<b>2.1</b> What is a social enterprise? .....	<b>4</b>
<b>2.2</b> What are the different types of social enterprises in Singapore? .....	<b>5</b>
<b>2.3</b> Is a social enterprise for-profit or not-for-profit? .....	<b>6</b>
<b>2.4</b> How is a social enterprise different from a charity with purely social objectives and a profit-making enterprise which is socially responsible? .....	<b>6</b>
<b>2.5</b> What are the applicable rules and guidelines for a charity running a social enterprise? .....	<b>8</b>
<b>2.6</b> What are the different organisational forms that a social enterprise can take and what are the applicable rules, regulations, codes and other guidelines? .....	<b>9</b>
<b>2.7</b> What is governance?.....	<b>10</b>
<b>2.8</b> Why is good governance important for a social enterprise?.....	<b>11</b>
<b>2.9</b> Who are the key stakeholders of a social enterprise? Which stakeholder group's interests are most important for a social enterprise? .....	<b>12</b>
<b>3 BOARD OF DIRECTORS</b> .....	<b>13</b>
<b>3.1</b> Is the social enterprise required to have a board of directors? .....	<b>13</b>
<b>3.2</b> Should a social enterprise establish a board of directors or equivalent even if is not legally required to do so? .....	<b>13</b>
<b>3.3</b> How large should the board be? .....	<b>14</b>
<b>3.4</b> Should executives and employees of the social enterprise serve on the board? .....	<b>14</b>
<b>3.5</b> What are the different kinds of directors on a board of directors? What are their duties? .....	<b>14</b>
<b>3.6</b> How is the Chairman appointed and what attributes make a good Chairman? .....	<b>14</b>
<b>3.7</b> Why is it important for the chairman of the board to be separate from the chief executive officer? .....	<b>15</b>
<b>3.8</b> What kinds of experience, backgrounds and personal traits are most important for directors, how can such directors be attracted to join the board and how should they be appointed?.....	<b>16</b>
<b>3.9</b> What kinds of information and briefings should directors get before and immediately after they join the board? .....	<b>17</b>
<b>3.10</b> What kinds of ongoing professional development may be useful for directors and where can directors avail themselves to such professional programmes? .....	<b>17</b>
<b>3.11</b> How can directors contribute effectively to board decisions and to the performance of the social enterprise?.....	<b>17</b>
<b>3.12</b> What is the role of the board compared to management? What are the key decisions that the board should spend most of its time on?.....	<b>18</b>
<b>3.13</b> What is the role of the board in the setting of the mission, vision and core values and the development of the long-term strategies, goals, action plans and budgets?.....	<b>19</b>
<b>3.14</b> How should the board oversee the implementation of strategies and the achievement of goals, action plans and meeting of budgets? .....	<b>19</b>
<b>3.15</b> Should the board form committees to help it in its work and, if so, what kinds of committee should it form and how should it go about doing so? .....	<b>19</b>
<b>3.16</b> How should the board delegate decisions to committees and management and how should it ensure that it is still able to fulfil its ultimate responsibility for these decisions?.....	<b>20</b>
<b>3.17</b> How often should the board meet and how should it plan its meetings?.....	<b>20</b>
<b>3.18</b> What is the role of the Chairman and CEO in planning for the agenda of board meetings? .....	<b>20</b>
<b>3.19</b> How should the Chairman conduct board meetings to ensure that they make full use of the time and expertise of the directors? .....	<b>21</b>
<b>3.20</b> How can the board make urgent decisions outside of formal board meetings? .....	<b>21</b>
<b>3.21</b> What are the key types of information that should be provided to the board on a regular basis and at board meetings? .....	<b>21</b>
<b>3.22</b> How can the board improve its effectiveness? .....	<b>22</b>
<b>4 CONFLICT OF INTEREST</b> .....	<b>23</b>
<b>4.1</b> What kinds of conflict of interests are most pertinent for a social enterprise and how can it manage these conflicts? .....	<b>23</b>
<b>4.2</b> What are related party transactions? .....	<b>24</b>
<b>5 REMUNERATION AND PEOPLE MANAGEMENT</b> .....	<b>26</b>
<b>5.1</b> Should board members of social enterprises be paid and, if so, how can the appropriate amounts be determined? .....	<b>26</b>
<b>5.2</b> How should senior management and staff of social enterprises be paid and how can the appropriate amounts be determined?.....	<b>26</b>
<b>5.3</b> What formal processes or procedures should be used in developing remuneration policies and setting remuneration packages for board members, senior executives and employees? .....	<b>27</b>
<b>5.4</b> If the social enterprise employs disadvantaged groups, how should it ensure these groups are treated fairly? .....	<b>28</b>
<b>6 FINANCIAL MANAGEMENT AND PERFORMANCE MONITORING</b> .....	<b>29</b>
<b>6.1</b> What kinds of budgets should a social enterprise prepare to ensure that it is financially well managed?.....	<b>29</b>
<b>6.2</b> How should the achievement of these budgets be monitored?.....	<b>29</b>
<b>6.3</b> What other aspects of performance should be monitored by senior management and the board? .....	<b>29</b>
<b>7 RISK MANAGEMENT AND INTERNAL CONTROL</b> .....	<b>30</b>
<b>7.1</b> What are some of the key risks applicable to a social enterprise and how should a social enterprise manage these risks?.....	<b>30</b>
<b>7.2</b> What are the key internal controls that a social enterprise should have in place? .....	<b>31</b>
<b>7.3</b> Should the social enterprise form an audit committee? What kinds of expertise and background are most valuable for audit committee members? .....	<b>31</b>
<b>7.4</b> Should the social enterprise have an internal audit function? .....	<b>32</b>
<b>8 DISCLOSURE, TRANSPARENCY AND COMMUNICATION WITH STAKEHOLDERS</b> .....	<b>33</b>
<b>8.1</b> What are the requirements that the social enterprise has to comply with to fulfil its accountability to stakeholders? .....	<b>33</b>
<b>8.2</b> In addition to any statutory information, what kinds of information should the social enterprise disclose to discharge its accountability to stakeholders (e.g., members, shareholders, beneficiaries, grant-makers)? .....	<b>34</b>
<b>CHECKLIST ON KEY GOVERNANCE ISSUES FOR A SOCIAL ENTERPRISE</b> .....	<b>35</b>
<b>ABOUT THE AUTHOR</b> .....	<b>39</b>
<b>ABOUT SOCIAL ENTERPRISE ASSOCIATION</b> .....	<b>40</b>

## FOREWORD

With a national mandate to promote social entrepreneurship and build capacity for social enterprise, Social Enterprise Association is launching this Primer on Governance for Social Enterprises in Singapore.

Social enterprises are registered organisations that apply business strategies to achieving social, cultural and/or environmental goals. They can be structured as for-profit or not-for-profit entities. To the extent that they are financially sustainable, they would be more effective in achieving their mission. In addition, the surpluses that are generated are applied in a way that keeps them true to their basic social, cultural and/or environmental mission.

Businessdictionary.Com defines governance as the “framework of rules and procedures by which a board of directors ensures accountability, fairness and transparency in a company’s relationship with its stakeholders (financiers, customers, management, employees, government, and community)”.

Customers and corporates who could buy or support social enterprises would want to know how the social impact that is promised is delivered by them as the sector matures. This is achieved through transparency about their governance structures and processes. Government, foundations, venture philanthropic funds and social impact investors such as SE Hub and members of Asian Venture Philanthropic Network (AVPN) would take a promise and then a proven track record of good governance as a critical factor in providing grants and equity support in developing individual firms and supporting the growth of the sector at large.

As such we at the Association recognise that this agenda of propagating good corporate governance is integral to what we do. Alongside this primer, the Association will present workshops to all social enterprises, cooperatives and individuals interested in social entrepreneurship in a way that is relevant to the challenge of balancing the demands of our double and triple bottomlines – financial sustainability, social and/or environmental impact.

We are very grateful for the expert advice and ground-level insights we have received from so many quarters in preparing this primer and wish to acknowledge these here.

The author, Associate Professor Mak Yuen Teen of NUS Business School, National University of Singapore;

Ms Nancy Frohman, Workshop Developer, Governance for Social Enterprises in Singapore and Principal, Columbia Business Services, Singapore;

Mr Eugene Tan, Assistant Professor of Law, Singapore Management University;

Mr Florian Hoppe, Principal, Bain and Company, Singapore;

Mr Gerard Ee, Chairman, Singapore Ministerial Salary Review Committee; National Kidney

Foundation; Council for Third Age;

Mr John Lim, Chairman, Singapore Institute of Directors;

Mr Kevin Teo, Chief Operating Officer, Asian Venture Philanthropy Network;

Mr Noel Hon, Chairman, ComCare Enterprise Fund; E-Cop Pte Ltd, NTUC Media Cooperative;

Mr Stanley Tan, Chairman, National Volunteer & Philanthropy Centre; CEO, Angliss Property Group;

Mr Willie Cheng, Board Member, Lien Centre for Social Innovation; formal Partner, Accenture Pte Ltd; Author, Doing Good Well; Co-editor, A World that Changes the World;

Ms Cindy Chng, Managing Director, ECO Travel Services Pte Ltd;

Ms Hazel Menon, Founder and Principal, Immanuel Beauty School;

Mr Henry Wong, Managing Director, Cadaq Pte Ltd;

Mr Isaiah Chng, Director, Proage Pte Ltd;

Mr Jared Tham, Manager, Research & Programmes, Lien Centre for Social Innovation;

Ms Leah Tan, Vice President, Enterprise Banking, Institutional Banking Group, DBS Bank, Singapore;

Ms Mette Kristine Oustrup, CEO and Founder, Qi GLOBAL Pte Ltd;

Mr Nicholas Chee, Founder, Sinema Media Pte Ltd;

Dr Rob John, Senior Visiting Fellow, Asia Centre for Social Entrepreneurship & Philanthropy NUS Business School Singapore;

Mr Robert Kraybill, Managing Director, Impact Investment Exchange Asia Pte Ltd; Board Member, Shujog Ltd;

Mr Seah Soon Huat, Deputy Director, Simei Care Centre, Singapore Anglican Community Services.

As always, we invite readers to write to us if there are ways in which this primer can be improved upon especially taking on board the particularities of Singapore’s social enterprise sector. We hope you find our primer useful.

Mr Seah Kian Peng, Co-chair;

Ms Penny Low, Co-chair;

Mr Alfie Othman, Board Member;

Dr Gillian Koh, Board Member; and

Ms Teo Mee Hong, Executive Director, Social Enterprise Association

29 Feb 2012

## 1 OBJECTIVE OF PRIMER

Social enterprises are an emerging form of organisation globally as societies increasingly recognise that enterprises with a social mission at its core can be run as businesses on a sustainable basis. As a relatively new form of organisation, what constitutes sound governance and business practices for such enterprises has received little attention. While governance guidelines have increasingly been promulgated for profit-making companies, charities and other types of organisations, social enterprises have certain nuances which may limit the application of some of these guidelines or require different guidelines.

This primer is intended to assist social enterprises in Singapore to think about key governance issues that may be relevant to them and to suggest how they can address these issues through the adoption of specific governance structures and practices. Some qualifiers are in order. While the primer seeks to be comprehensive, the issues covered are not exhaustive. The governance structures and practices that social enterprises need to have in place would depend to some extent on factors such as their legal structure and size. Smaller social enterprises may find some of the suggestions to be of less relevance to them, but they may still find the primer useful especially as they grow and develop. The primer is not targeted at co-operatives and charities with business activities as there are existing governance guidelines for such entities. Some reference (Section 2.9) is made to these guidelines. Again, the primer may be useful as a source of additional guidance for such entities.

This primer uses the more general term “governance” rather than “corporate governance” because social enterprises may not take a corporate form.

The primer is not designed to provide “one-size-fits-all” solutions and not intended to be prescriptive.

The objective is to assist social enterprises to use good governance principles and guidelines as an important tool for building sustainable businesses that deliver on their social missions. It is important that social enterprises do not just focus on compliance with rules. They should observe the principles and spirit underlying good governance.

The primer is written in a “question and answer” format, and organised in a logical manner starting from general issues to specific issues relating to governance.

## 2 GENERAL ISSUES

### 2.1 What is a social enterprise?

There is no single accepted definition of what is a social enterprise and it can mean different types of organisations in different parts of the world. The United Kingdom (UK) government’s Social Enterprise Unit, which is now part of the Office of the Third Sector, defines a social enterprise as “a business with primarily social objectives whose surpluses are principally invested for that purpose rather than being driven by the need to maximise profit for shareholders and owners.”<sup>1</sup> Such a broad definition would consider social enterprises to include:<sup>2</sup>

(a) “commercial ventures undertaken by not-for-profit organisations (including charities) to finance the NPO’s social mission”, or

(b) businesses which explicitly aim “to improve personal and collective well-being in reducing inequalities and increasing social cohesion, as well as benefiting the community, mainly through creation of decent jobs for marginalised and excluded people, reintegration of people with difficulties into the labour market, provision and delivery of collective goods and social services for low income individuals, increase of social capital and dissemination of social innovations.”

According to a major study in the UK, social enterprises comprise a diverse range of organisations. Some examples include co-operatives, community businesses, credit unions and trading charities.<sup>3</sup>

In the UK, the following questions are used to determine if an organisation qualifies for the Social Enterprise Mark there:<sup>4</sup>

- a) Does the company have social and/or environmental aims?
- b) Does the company have its own constitution and governing body?
- c) Does the company earn at least 50% of its income from trading?
- d) Is at least 50% of company profits spent on socially beneficial purposes?
- e) Can the company demonstrate that social/environmental aims are being achieved?
- f) If the company ceased trading, would remaining assets be distributed for social/ environmental purposes?

1 DTI, *Social Enterprise: A Strategy for Success*, London: Department for Trade and Industry, 2002.

2 A. Noya, *Emerging models of social entrepreneurship: possible paths for social enterprise development in Central East and South East Europe*, A seminar organised by the OECD LEED Trento Centre for Local Development and the Institute for the Development of Non-Profit Organisations (ISSAN) in co-operation with the United States Agency for International Development (USAID), 28-29 September 2006.

3 R. Spear, C. Cornforth and M. Aitken, *For Love and Money: Governance and Social Enterprise Report*, Social Enterprise Coalition and Governance Hub, 2008.

4 <http://www.socialenterprisemark.org.uk/>

It should be noted that the Social Enterprise Mark is a voluntary accreditation system unique to the UK and that there is no equivalent “SE Mark” in Singapore.

In Singapore, social enterprises can take on different organisational forms (as will be discussed later in this primer). They need not be established as companies.

Given that the social enterprise sector in Singapore is a diverse and creative one as it is elsewhere, what follows is a general set of characteristics of a social enterprise that will guide Singapore’s Social Enterprise Association in its work:

- It is designed specifically to address certain social, cultural and/or environmental issues;
- It declares this mission in its constitution or declares it publicly if it has no constitution;
- It uses business strategies and activities to tackle its stated mission;
- It generates and distributes its revenue and surpluses to achieve its stated mission.

In the case of some types of social enterprises, especially the work integration social enterprises designed to provide employment for the disadvantaged communities, it is recognised that such organisations have to cope with significant ‘business drag’ due to the levels of productivity of its workforce, and the incorporation of social and other non-business programmes that are needed to achieve their mission.

Each case will need to be carefully examined to establish if it is a social enterprise.

This primer is written to accommodate all the possible forms social enterprises might take here.

## 2.2 What are the different types of social enterprises in Singapore?

According to the Report of the Social Enterprise Committee (2007), there are four key social enterprise models in Singapore.<sup>5</sup> These are:

(i) Work integration model: These social enterprises provide skills training and/or employment opportunities to the needy and/or disadvantaged (such as ex-offenders) to help them reintegrate into society and encourage them to be self-reliant.

(ii) Plough-back-profit model: These social enterprises generate profit to fund the social programmes of their affiliated or parent charities.

(iii) Subsidised services model: These social enterprises provide subsidised services to needy and/or disadvantaged clients, and charge commercial rates to customers who can afford to pay.

(iv) Social needs model: These social enterprises are designed to serve society’s social needs or address certain social issues, such as community bonding and racial harmony.

## 2.3 Is a social enterprise for-profit or not-for-profit?

Social enterprises can be for-profit or not-for-profit enterprises. However, in all cases, they have a social mission and at the same time, seek to be self-sustaining with a significant proportion of their income derived from the sales of products or services. Social enterprises may also be supported by grants by government or other grant-makers.

However, some observers and social entrepreneurs believe our social enterprises should be not-for-profit and should not pay dividends. For example, according to Nobel Laureate Muhammad Yunus, the founder of Grameen Bank, the social enterprise model “involves a non-loss, non-dividend company that fundamentally addresses a social issue rather than focus on the bottom line.”<sup>6</sup>

A social enterprise model which is for-profit and which pays dividends to investors will need to articulate clearly to stakeholders why it is a social enterprise. Section 8 of this primer discusses the issues of disclosure, transparency and communication with stakeholders.

## 2.4 How is a social enterprise different from a charity with purely social objectives and a profit-making enterprise which is socially responsible?

According to the Charities Act in Singapore, charities are organisations set up exclusively for any of the following charitable objects:<sup>7</sup>

- a) the relief of poverty;
- b) the advancement of education;
- c) the advancement of religion; and
- d) other purposes beneficial to the community, which include:
  - i) the promotion of health;
  - ii) the advancement of citizenship or community development;
  - iii) the advancement of arts, heritage or science;
  - iv) the advancement of environmental protection or improvement;

<sup>6</sup> A. Lee and J. Tan, “Doing business for betterment of society”, Business Times, 25 February 2012.

<sup>7</sup> <https://www.charities.gov.sg/charity/index.do>

- v) the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantages;
- vi) the advancement of animal welfare; and
- vii) the advancement of sport, where the sport promotes health through physical skill and exertion.

A social enterprise may have a social mission which is similar to one or more of the above charitable objects. However, compared to a charity, a social enterprise has a risk-taking attitude, aims at self-sustainability, and deals with the market economy.<sup>8</sup> According to the Social Enterprise UK, profits from the social enterprise can be distributed as profit-sharing to stakeholders or used for the benefit of the community.<sup>9</sup> This also sets it apart from a charity.

Compared to a profit-making enterprise which is socially responsible, a social enterprise is defined by its social objectives and these objectives are as important as the economic and financial ones. The organisation focuses on the collective interest of stakeholders, and is socially responsible towards employees, customers and in its products.<sup>10</sup> The Figure below, taken from the Report of the Social Enterprise Committee, compares a social enterprise with a business which is socially responsible.

Figure 1: Social Entrepreneurship/Social Enterprise Compared with Socially-Responsible Business

	Business with CSR		Social Entrepreneurship /Social Enterprise
	CSR secondary emphasis	CSR strong emphasis	
Primary Beneficiaries	Shareholder		Marginalised sectors
Primary Objectives (Motivation)	Single Bottom Line		Double or triple bottom line -Social goal equal or superior status to other goals
Enterprise Philosophy	Accumulative		Distributive
Social Goal	Separate from Business models	Achieved as part of Business model	May detract from business model

Source: Report of the Social Enterprise Committee, November 2007, p.74.

## 2.5 What are the applicable rules and guidelines for a charity running a social enterprise?

A charity may wish to establish a social enterprise to help fund its charitable activities. In this case, the social enterprise is part of the charity. If the social enterprise is part of an overall entity registered as a charity or Institution of Public Character (IPC), it would be subject to the Charities Act and regulations, and where applicable, rules and regulations for IPCs. It would then also be subject to applicable principles and guidelines in the Code of Governance for Charities and IPCs on a “comply or explain” basis, and any sector-specific rules and regulations prescribed by sector administrators.

The Commissioner of Charities (COC) has issued guidance on charities engaging in business activities.<sup>11</sup> Under this guidance, the charity should establish a separate business subsidiary if it wishes to undertake “non-primary purpose activities” which have a material impact on the financials of the charity and which exposes the charitable assets to significant risks. The COC guidance states that non-primary purpose activities “do not directly advance or support the objects of the charity, and usually involves the provision of goods and/or services in return for income.” In other words, a charity which runs a social enterprise to generate income to support its charitable activities may need to create a separate subsidiary to do so. The COC guidance, however, states that primary purpose and incidental trading activities may be undertaken by a charity without establishing a separate business subsidiary. Primary purpose activities are defined as “activities that contribute directly to the advancement of one or more of a charity’s objects stated in the governing instrument.”<sup>12</sup> The COC guidance gives some examples of primary purpose activities, such as a family service centre whose aim is to help dysfunctional families providing family counselling services at a fee. Incidental activities support the advancement of a charity’s objects, such as providing childcare services in a church for parents who attend church services.

It is prudent for the board of a charity which wishes to engage in a social enterprise to consider carefully whether it has the expertise to do so and whether it should undertake the social enterprise activities through a separate business subsidiary. The guidance points out that board member of a charity may be personally liable for any loss in value of the charity’s assets if they use the charity assets or expose the charity’s assets to significant risk in order to benefit the subsidiary.

The COC guidance emphasises the need for charity boards to act in the best interests of the charity and the importance of maintaining an arms-length relationship between the charity and the business subsidiary in order to protect the interests of the charity.

8 Ibid.  
9 www.socialenterprise.org.uk  
10 Ibid.

11 Office of the Commissioner of Charities, Guidance for Charities Engaged in Business Activities, July 22, 2011.  
12 Ibid.

It is better for the business subsidiary not to have an identical board of directors as the charity. This is to ensure that the business subsidiary is considered as a bona fide separate entity and has reasonable operational independence, and that its risks are effectively “ring-fenced”. Furthermore, charity board members are often recruited with the charity’s mission and objects in mind, and may not possess the business expertise necessary to run a successful business. The business subsidiary board needs to be adequately equipped to successfully oversee the business activities.

If the social enterprise is undertaken through a charity, whether under a separate business subsidiary or not, all the profits of the social enterprise, must be ploughed back as dividends into the charity.

If the social enterprise is not conducted through a charity, the founder(s) need to consider whether the social enterprise should be set up as a not-for-profit entity or a for-profit entity. A for-profit entity may distribute its profits to its members/investors. This is discussed further in this primer.

## 2.6 What are the different organisational forms that a social enterprise can take and what are the applicable rules, regulations, codes and other guidelines?

A social enterprise can take many forms such as a sole proprietorship, partnership, co-operative, company limited by guarantee or company limited by shares. The toolkit for starting a social enterprise, published by the Social Enterprise Association, provides more details on these different forms.<sup>13</sup> A company limited by shares may be a public company, private company or exempt private company. Each form has advantages and disadvantages, different governance structures, and different rules and regulations which are applicable. For example, a company limited by guarantee or shares has the advantage of limited liability of its members and a perpetual existence, while a sole proprietorship or ordinary partnership does not. However, there are generally higher compliance costs for companies. It is important for the founder(s) of the social enterprise to seek appropriate advice, such as from the Social Enterprise Association, as to the appropriate form.

A company, whether limited by shares or guarantee, is governed by the Companies Act and the company’s own constitutive documents (memorandum and articles of association). A social enterprise which chooses the company form is likely to be either a company limited by guarantee if it is not-for-profit, or a private or exempt private company limited by shares if it is for-profit. A private company must restrict the transferability of shares and the number of members to not more than 50, while an exempt private company must have not more than 20 members. The requirements in the Companies Act are generally more onerous for companies limited by guarantee and public companies limited by shares, compared to private companies. Exempt private companies have the least onerous requirements - for example, they do not have to file accounts.<sup>14</sup>

A company structure generally offers greater continuity as it is a legal entity separate from its owners, has to meet higher standards of transparency and accountability, and provides greater protection to key stakeholders. However, there are generally higher compliance costs associated with a company structure.

If a social enterprise is a co-operative society, it is subject to the Co-operative Societies Act and the co-operative’s own constitutive documents. In addition, the Singapore National Co-operative Federation (SNCF) has collaborated with regulators to develop best practice corporate governance principles and guidelines for credit co-operatives and other co-operatives which are tiered for those with annual turnover below \$500,000 and those with annual turnover of \$500,000 or more. A co-operative fulfils the criteria for a social enterprise because (a) it is set up to meet the needs of its members by providing goods and services, rather than to make a profit, (b) members can be rich or poor, (c) co-operatives pay a levy which is used for the development and promotion of the co-operative movement and to help other co-operatives in need, (d) surpluses are returned to their members based on their usage of these goods and services, rather than based on their investment or ownership share, and (e) members will receive at most their share capital, dividends (if applicable) and any patronage rebates upon liquidation, but not surpluses from the liquidation.<sup>15</sup>

## 2.7 What is governance?

There are many definitions of governance and corporate governance but perhaps the most widely cited definition is the one by the Organisation for Economic Cooperation and Development (OECD) which states: “Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.”<sup>16</sup>

This definition is useful because it explicitly recognises stakeholders other than shareholders. While stakeholders other than just shareholders or investors are important for profit-making organisations, it is even more important for a social enterprise to consider the interests of different stakeholder groups.

As the definition suggests, good governance for a social enterprise requires the effective management of the relationships between management, the board, investors and other stakeholders, and appropriate structures, systems, processes and incentives supporting these relationships. Clearly, these structures, systems, processes and incentives depend

<sup>13</sup> Social Enterprise Association, Starting a Social Enterprise in Singapore: An Essential Toolkit, March 2011.

<sup>14</sup> The current review of the Companies Act includes a proposal to abolish the concept of exempt private company.

<sup>15</sup> Singapore National Co-operative Federation, [www.snfc.org.sg](http://www.snfc.org.sg).

<sup>16</sup> Organisation for Economic Cooperation and Development (OECD), OECD Principles of Corporate Governance, 2004.

to a great extent on factors such as the legal form of the social enterprise and its stage of development. They are also affected by rules and regulations imposed by regulators and other stakeholders.

Governance has often been equated with compliance with rules and regulations, and with structures, controls, systems and processes. While good governance requires attention to these, good governance is much more than that. It is more about having a strong ethical culture within the organisation, applying the spirit rather than letter of rules and regulations, and paying attention to substance rather than form. Good governance is also ultimately about having good people steering the social enterprise. The ethics of the founders, board members and management is critical to good governance and determines the “DNA” of a social enterprise.

## 2.8 Why is good governance important for a social enterprise?

Good governance is important for a social enterprise to grow and be sustainable. As the Director General of the Third Sector in the UK stated: “Good governance provides legitimacy, accountability and transparency for all stakeholders, and provides a framework for responsible decision-making and safeguards for investors.”<sup>17</sup>

Investors and other stakeholders increasingly demand good governance as a condition for supporting the social enterprise. This has been accentuated by scandals in the for-profit and not-for-profit sector in Singapore and elsewhere, and the recent global financial crisis, which have unfortunately led to a loss of trust in businesses and have taught valuable lessons that organisations can be destroyed almost overnight if they are not well-governed.

Good governance not only helps better ensure the survival of a social enterprise and results in better long-term performance, it also builds trust with stakeholders enabling the development and strengthening of long-term relationships.

More organisations are focusing on corporate social responsibility and sustainable development. Multinational organisations are also putting more attention to the governance of their business partners along the supply chain. Some multinationals have discovered how poor governance and ethical standards of their business partners, suppliers and subcontractors can impose considerable legal and reputational risks on themselves, especially with the increased emphasis on cross-border violations relating to bribery, labour laws, and environmental protection. Many of these multinationals are adopting supplier codes of conduct and undertaking supplier audits.

Social enterprises which have a strong social mission and which govern themselves well can use these attributes as a source of competitive advantage. On the other hand, a

scandal not only hurt the organisation but also the social mission that the organisation involved seeks to promote, as customers and members of the community may become cynical about the cause as well.

## 2.9 Who are the key stakeholders of a social enterprise? Which stakeholder group's interests are most important for a social enterprise?

The most important stakeholders for a social enterprise are its beneficiaries – those whom the social enterprise is set up to benefit in the first place, such as a particular disadvantaged group or persons, or the community at large (e.g., in the case where a social enterprise is set up to benefit the community as a whole, such as those focusing on environmental causes). Other key stakeholders include employees, customers, members, grant-makers and investors. There could be significant overlap among different stakeholder groups – for example, employees and customers could also be beneficiaries.

A social enterprise should be socially responsible towards its key stakeholders and in the delivery of its products and services.

<sup>17</sup> Robb, C., Director General of the Office of the Third Sector, Foreword, For Love and Money: Governance and Social Enterprise Report, Social Enterprise Coalition and Governance Hub, 2008.



## 3 BOARD OF DIRECTORS

### 3.1 Is the social enterprise required to have a board of directors?

A board of directors is mandatory for a company and the Companies Act requires a company to have at least one director who is ordinarily resident in Singapore. A society is required to have a committee of management of not less than 5 and not more than 30 members under the Co-operative Societies Act. Other types of entities, such as a sole proprietorship, may not require a board of directors or equivalent body.

### 3.2 Should a social enterprise establish a board of directors or equivalent even if is not legally required to do so?

A board of directors is useful for providing better oversight over the activities and management of the social enterprise and can also be a useful source of advice to management. It can therefore improve the accountability, long-term performance and sustainability of the social enterprise. However, to be able to achieve these objectives, the board must be thoughtfully constituted with the right people and never with the sole objective of compliance in mind. There should be appropriate provision for rotation and renewal. A term limit, especially for directors who are not involved in management (non-executive directors), can be considered to encourage renewal. The board must also understand clearly its roles and responsibilities vis-a-vis management.

If a social enterprise is not required to establish a board of directors and does not believe that the benefits of having such a board exceeds the costs, it may wish to consider establishing an advisory board or panel instead. Such a board or panel will have a more limited role of providing advice to management and does not have a governing role. As the enterprise grows and has accountability to more stakeholders, governance will become a more important consideration. The advisory board may then evolve into a governing board.

It is important to bear in mind that the appropriate composition of an advisory board is different from that of a governing board. An advisory board may comprise individuals selected more on the basis of their passion for the cause, their knowledge and their connections. While these may also be important for a governing board, a governing board first and foremost has a fiduciary duty of acting in the best interests of the enterprise, and would necessarily need to better balance the “performance” and “conformance” (or accountability) of the enterprise. A governing board needs a robust “challenge” function and may overrule management, while an advisory board is there largely to support management and the organisation. Some organisations have both a governing board and an advisory board, and large social enterprises may also consider doing so.

In the rest of this primer, unless otherwise indicated, a board refers to a governing board.

### 3.3 How large should the board be?

Smaller is generally better from the point of view of being able to make decisions efficiently and also to maximise the contributions of individual members. However, this has to be balanced against ensuring that there are sufficient skills, knowledge, and experience and a diversity of viewpoints. A good range in terms of board size for an established enterprise is between six to eleven, although the appropriate size will depend on the complexity of the business. A social enterprise that is in a start-up phase or is relatively small may find that a board of three to four members will suffice.

### 3.4 Should executives and employees of the social enterprise serve on the board?

To keep the roles and responsibilities of the board distinct from management and for a board to be effective in discharging its responsibilities, it is best to keep executive/employee representation on the board to a minimum. However, it makes sense to have the chief executive or equivalent on the board to ensure that he has a say in board decisions and to also ensure that he is held to a higher standard of accountability as a director. Other executives and employees can be invited to board meetings on an ex-officio basis as needed.

### 3.5 What are the different kinds of directors on a board of directors? What are their duties?

Directors can be classified into executive directors and non-executive directors. Executive directors are occasionally called employee directors or management directors, and they have full-time roles in the organisation. Other directors are called non-executive directors. In some sectors, such as the listed company sector, non-executive directors are further classified into those who are considered independent and those who are not, based on whether there are certain relationships between the director and the company, other related companies, key officers and major shareholders. While all directors are considered fiduciaries and have the same legal duties of loyalty, care, skill and diligence, non-executive directors are less conflicted because they are not involved in management and are therefore expected to play a larger role in overseeing management.

### 3.6 How is the Chairman appointed and what attributes make a good Chairman?

A good Chairman is absolutely critical for an effective board and for the board to be able to work well with management. Unless otherwise provided for in the constitutive documents, the Chairman is appointed by the members of the board of directors. A good Chairman must have strong leadership skills but yet not be domineering. The Chairman should be willing and able to commit more time than other non-executive directors in developing a good understanding of the business of the social enterprise, in developing rapport between

the board and the chief executive officer, to participate at important external events, and to work with management to plan the agenda for board meetings.

### **3.7 Why is it important for the chairman of the board to be separate from the chief executive officer?**

There are several reasons why it is important to separate the two roles. First, to ensure that there is not too much power concentrated in one individual and to ensure some checks and balances at the top of the enterprise. Where the CEO also chairs the board, there is an inherent conflict as the board is supposed to approve strategies proposed by management and monitor the implementation of these strategies. The board is also supposed to oversee management, including approving the remuneration of management and evaluating management's performance.

Second, the separation of roles allows the CEO to focus on growing the social enterprise, formulating and implementing strategies and on day-to-day management, and the Chairman to lead the board to focus more on the overall direction, core values, key risks, broad policies and oversight, and providing advice to management.

Third, the separation of roles may allow for a better utilisation of talent as the attributes of a good CEO for a social enterprise can be quite different from the attributes of a good Chairman. For example, a good CEO of a social enterprise is likely to be entrepreneurial and passionate about the social mission, but may not have the right skills set to lead the board and get the most out of the directors.

However, when a social enterprise is relatively new or small, it may opt to have the CEO or founder also acting as the Chairman as growth considerations and the ability to make speedy decisions may outweigh governance considerations. However, the social enterprise needs to be aware that a concentration of power brings with it risks of abuse of power. In order to gain the confidence of stakeholders, it should consider setting up appropriate checks and balances, such as having more independent members on the board or a committee or person to audit or review major decisions, and ensure that it is sufficiently transparent to its stakeholders.

As a social enterprise grows, it may find that separating the two roles not only allows for better governance, but also ensures that the social entrepreneur is able to focus on using his strengths to grow the enterprise, while having someone else run the board. A very large social enterprise may even find that it is better not to have the social entrepreneur involved in day-to-day management or in running the board so that he can focus on new ideas and innovations. For example, in some large companies founded by entrepreneurs, the founder transitioned over time from a founder-cum-CEO-cum-Chairman role, to eventually assuming a role like a chief strategy officer (or in Bill Gates' case, to a chief software architect at one time) and leaving the role of CEO to someone else.

### **3.8 What kinds of experience, backgrounds and personal traits are most important for directors, how can such directors be attracted to join the board and how should they be appointed?**

There are three key "C's" that one should look for in all directors - character, commitment and competencies. Every director should have the first two "C's" in that they are individuals of good character (and also possess other important personal attributes like ability to exercise judgement, willingness to ask questions, ability to work with others) and be able to commit the time and are committed to the cause. The board collectively should ideally have a mix of competencies in areas such as industry knowledge, business management experience, law, accounting and finance, human resource management, and so on. It is important to have sufficient diversity in competencies and viewpoints so that key board decisions are considered from sufficient perspectives and the board is able to effectively discharge its governance responsibilities.

Some individuals may be willing to join the board purely because of their friendships or other dealings with the founders. These individuals may be less likely to take their governance responsibilities seriously and may also not have the right competencies. In the case of social enterprises, the most important factor determining the ability to attract good directors is its cause or mission. It is unlikely, nor is it desirable, that a social enterprise will attract directors who see a directorship purely as a job and a source of income as in the case of mainstream businesses. Good directors also want to protect their reputation and would therefore be more likely to be attracted to serve if they believe that the founder/CEO is an individual with integrity and who is passionate about the enterprise, and that the founder and board chairman are receptive to alternative views. A dominant founder or chairman is likely to have difficulty attracting good people to join the board.

The appointment process for directors is governed by the constitution if there is one (e.g., articles of association for a company). For example, the articles may provide that directors may be appointed by the board without being elected by members, or it may provide that directors can be appointed by the board but have to be elected at the next general meeting of members. It is useful to have a proper search and nomination process in place, which can be overseen by a nominating committee. This would include identifying the attributes being sought in new directors, searching for candidates, interviewing and doing due diligence on candidates, before they are recommended to the board for appointment. There are a number of organisations which can assist in the identification of potential candidates, such as the Centre for Non-Profit Leadership and Singapore Institute of Directors.

### 3.9 What kinds of information and briefings should directors get before and immediately after they join the board?

Any director who joins an organisation, for the first time, needs to be briefed about the organisation (e.g., its mission, key strategies, structure, constitution, major policies, etc.), its industry (especially if the director is new to the industry) and the key rules and regulations affecting the organisation. If a director has never been on a board, he will need to attend training on his duties as a director. If he is new to a social enterprise, he should be briefed about what it is and how it is different from other organisations he may be familiar with.

### 3.10 What kinds of ongoing professional development may be useful for directors and where can directors avail themselves to such professional programmes?

It is important for directors to keep themselves up to date with key developments in the industry, changes in rules and regulations, and best practices in areas which they are most expected to contribute to (such as accounting or governance). Some of this may be done by the organisation itself, but more likely, the organisation will have to provide support for directors to attend appropriate courses and seminars offered by external organisations, such as the Singapore Institute of Directors, Social Service Training Institute, Asia Centre for Social Entrepreneurship and Philanthropy at the National University of Singapore, Lien Centre for Social Innovation at the Singapore Management University, and professional accountancy bodies. A charity will be able to avail itself to financial assistance provided by the VWOs - Charities Capabilities Fund (VCF) for professional development of directors and management.

### 3.11 How can directors contribute effectively to board decisions and to the performance of the social enterprise?

It is absolutely critical for the board to understand its responsibilities so that it is able to discharge them effectively without over-reaching into management. The main role of a board is a governing or oversight role, but the board is also there to provide advice to management. Given that management has an interest in the matters that are overseen by the board, the responsibilities for oversight and advice fall mainly on the non-executive directors.

It is important for non-executive directors to make constructive contributions to board decisions. This means asking questions where necessary, and asking further questions or seeking additional information if the non-executive directors do not feel that they do not have an adequate basis for making their decisions. However, non-executive directors should treat management and fellow directors with respect, and this means having the skill to ask questions in a professional manner and to be willing to consider alternative viewpoints.

While non-executive directors have an important governance role, it is also important to bear in mind that ultimately, they are there to improve the long-term performance of the social enterprise. Good governance is critical but it is a means to an end. Good governance does not mean the imposition of unnecessary bureaucracy and controls. It is also not to reduce the willingness of the social enterprise to take risks as doing business is about taking risk. However, non-executive directors need to ensure that they understand the key risks and that they have reasonable assurance that the social enterprise have processes in place to manage those risks.

### 3.12 What is the role of the board compared to management? What are the key decisions that the board should spend most of its time on?

This depends primarily on factors such as the stage of development and size. However, it is also affected by the board's confidence in senior management. Often when an organisation has gone through a crisis involving senior management, the board will take on a more hands-on role while it looks for a replacement and will often remain hands-on for sometime after that, as the new CEO familiarises himself with the organisation and the organisation rebuilds its reputation.

However, in a relatively mature and large social enterprise, the board should primarily be involved in oversight and advice, while management is responsible for operations and execution. This will also allow the board to hold management accountable for performance.

The board should therefore be focused more on factors that affect the long-term performance of the social enterprise, such as the mission, vision, core values, strategies, broad policies and key decisions with potentially significant impact, and of course on holding management accountable for performance.

Some organisations have a written statement of the board's reserved powers - that is, the matters that require board's (or board committees') approval. The board should also approve delegation of authority to board committees and management for key operational and financial matters, such approval of credit limits for customers, write-offs of bad debts, procurements, etc. This is often called a delegation of authority matrix or chart of authority. The statement of the board's reserved powers and delegation of authority matrix ensure that the board maintains proper control over delegation of the board's authority while, at the same time, provide clarity to management regarding what they can do without seeking approval from the board and board committees.

### **3.13 What is the role of the board in the setting of the mission, vision and core values and the development of the long-term strategies, goals, action plans and budgets?**

As mentioned earlier, the role of the board does vary depending on the circumstances. However, the “steady state” is for the board to have a more involved, somewhat “top-down” role when it comes to the mission, vision, and core values, and to have a more “bottom up” approach when it comes to the development of strategies, goals, action plans and budgets.

### **3.14 How should the board oversee the implementation of strategies and the achievement of goals, action plans and meeting of budgets?**

The board’s role is to review and, where it deems appropriate, to approve the strategies and budgets; and to monitor the implementation of strategies, goals and action plans and performance. The board also needs to have reasonable assurance that there are proper processes underpinning, and appropriate and competent people who are involved in, the development of strategies, goals, action plans and budgets.

### **3.15 Should the board form committees to help it in its work and, if so, what kinds of committee should it form and how should it go about doing so?**

Board committees have two basic roles. One role is to assist in the board in its decision-making, for example by studying matters that are to be decided by the board in greater detail, and in some cases, to approve decisions on behalf of the board. The second role is to assist the board in discharging its responsibilities in certain key areas that management or the board faces greater conflicts of interest, such as remuneration, appointment of directors, financial reporting, audit and so on. Unless it is required by regulations to do so, boards should ensure that it makes sense for a committee to be formed.

If the board has decided to establish a certain committee, it needs to ensure that the committee has an appropriate chair and members with the appropriate skills and experience, approve the appointment of the chairman and members, ensure that the committee has a terms of reference approved by the board which governs its operations, and keep itself sufficiently informed about the work of the committee (for example, through reviewing the minutes of the committee or to have the committee chair present the key activities and decisions of the committee). It is important to bear in mind that the board is ultimately responsible and therefore has to adequately “supervise” the committees.

### **3.16 How should the board delegate decisions to committees and management and how should it ensure that it is still able to fulfil its ultimate responsibility for these decisions?**

Before any decisions are delegated to a committee (or to management), the board should ensure that it is authorised to delegate in its constitutive documents, and such delegations should be made very clear in the terms of reference of the committee.

### **3.17 How often should the board meet and how should it plan its meetings?**

There are no hard and fast rules as to how often the board should meet. Often, boards are inactive and meet infrequently, especially for organisations other than listed companies. The board needs to meet frequently enough and spend enough time to be able to discharge its responsibilities. It is important for the frequency of board meetings not to be driven by management, as is sometimes the case. The chairman of the board, or if the chairman is the CEO, the other non-executive directors, need to be proactive in ensuring that the board meets regularly enough.

As non-executive directors are often busy people with many demands on their time, it is important to plan as far ahead as possible for board meetings. In many organisations, board meetings are scheduled one year in advance. Of course, there should be some flexibility in changing meeting dates and there may also be a need for the board to meet at other times. Boards can also make decisions by email/circulation subject to the rules specified in the constitution.

### **3.18 What is the role of the Chairman and CEO in planning for the agenda of board meetings?**

The Chairman and CEO (assuming that they are separate persons) need to work together to plan the agenda for board meetings. The Chairman should ensure that matters covered in the agenda are related to the responsibilities of the board and that important decisions requiring board approval are put at the top of the agenda where most board members are likely to be present and so that enough time is available for the board to deliberate. The Chairman needs to ensure that the board is provided with adequate information presented in an appropriately succinct manner for the board to be able to make an informed decision. There are usually routine matters requiring board decisions that can be dealt with relatively quickly, for example, opening of bank accounts and disposals of obsolete assets such as motor vehicles.

Boards often find it useful to organise the agenda and related information into those requiring Approval, followed by those requiring Discussion, and those for Noting (or Information).

### **3.19 How should the Chairman conduct board meetings to ensure that they make full use of the time and expertise of the directors?**

The Chairman is critical to the effective functioning of the Board and conduct of board meetings. The Chairman should seek to ensure that there is adequate discussion before key decisions are made. Where particular directors are less participative in board discussions, the Chairman should consider seeking their views individually at the meeting.

Differences of viewpoints and the willingness of directors to express their views freely and professionally are an important hallmark of an effective board. The Chairman should encourage directors to express their views freely while ensuring that discussions remain focused on the issue at hand and that the board is able to arrive at a decision. He or she may need to intervene if the discussion goes out of hand or becomes too protracted, and as far as possible, get the board to make a decision even if there is no consensus.

The Chairman should ensure that proper and accurate minutes of meetings are recorded on a timely basis and circulated to other directors for their comments within a reasonable time after the board meeting. He should ensure that key points of discussion and dissenting views relating to decisions are recorded.

### **3.20 How can the board make urgent decisions outside of formal board meetings?**

It is important to ensure that the constitutive documents allow the board to make urgent decisions outside of board meetings, referred to as decisions by circulation. This may be by email. The constitutive documents may specify certain requirements for decisions by circulation, such as 75 percent of directors or all directors agreeing. These decisions may also have to be ratified at the next board meeting.

Important decisions should generally not be made by circulation as they may require a full discussion which is more effectively achieved through a physical meeting. Ad hoc board meetings should be convened if necessary to discuss and make such decisions.

### **3.21 What are the key types of information that should be provided to the board on a regular basis and at board meetings?**

As mentioned earlier, the board should be focused more on factors that affect the long-term performance of the social enterprise, such as the mission, vision, core values, strategies, broad policies and key decisions with potentially significant impact, and holding management accountable for performance.

Information which should be provided to the board for each meeting include periodic reports (such as monthly) on financial performance compared to budgets and past performance,

and trends in other key operating information (such as employee satisfaction, employee turnover, customer satisfaction, major new customers). Other information to be provided at each meeting includes follow-up actions from recommendations or decisions by the board at the previous meeting (this is usually covered in “matters arising from the previous meeting” in the minutes) and information relating to decisions that the board is asked to made. It is also useful for the CEO to provide a brief report of key activities in the social enterprise since the last meeting to keep the board informed.

Other information which should be provided to the board on a “need to” basis include any proposed changes to the mission, vision, core values, strategies and key policies (the board may, and should, periodically initiate reviews of these matters) and updates on important developments which can potentially affect the social enterprise (such as regulatory changes, industry trends), and key risks.

### **3.22 How can the board improve its effectiveness?**

The effectiveness of the board is dependent on many factors, including appropriate selection of board members, proper induction and professional development, an effective Chairman, good meeting processes, and adequate information being provided to board members.

Just as employees need feedback about their performance in order to improve, the board can also benefit from feedback about its performance in order to improve its effectiveness. The effectiveness of the board should periodically be assessed, preferably annually. This is usually done through a self-assessment, whereby individual board members are asked to confidentially rate the board in areas such as board’s involvement in strategy and planning; board structure and role; meeting processes; board’s involvement in performance monitoring; board and director responsibilities; and board culture and relationships. Opportunities are given for board members to provide qualitative comments and suggestions for improvement. Some organisations also include interviews with individual board members, while others ask senior management for feedback. A company secretary or other external party may be asked to consolidate the ratings and feedback, which are then shared with the board and discussed.

Some boards also practise assessment of performance of individual board members, whereby individual board members’ effectiveness are self-assessed and also assessed by their peers. Others also practise assessment of the Chairman and board committees.

## 4 CONFLICT OF INTEREST

### 4.1 What kinds of conflict of interests are most pertinent for a social enterprise and how can it manage these conflicts?

Conflicts of interest occur when the interest of a board member or staff conflict with the interest of the social enterprise. A “conflict of interest” may arise where a board member or staff personally has an interest in a decision or transaction, or where his close relatives, or an organisation which is affiliated to him or his close relatives, has such an interest.

Potential conflicts of interest can arise in more situations than many people realise. Examples of situations which can give rise to a conflict of interest include:<sup>18</sup>

- a. setting of remuneration of the board member or staff;
- b. any interest in business transactions or contracts that the social enterprise may enter into;
- c. any interest in other organisations that the social enterprise has dealings with or is considering entering into joint ventures with;
- d. any interest as the social enterprise’s suppliers, service users, beneficiaries or staff;
- e. any interest in other organisations which compete with the social enterprise; and
- f. appointment of staff with close relationship (i.e. those who are more than acquaintances) with board members or staff

Some conflicts are serious and should be avoided, such as having interests in organisations that compete with the social enterprise. However, it is often not feasible or even desirable to avoid all conflicts. For example, it may not make sense to bar someone from being a board member just because there is a potential conflict, for example, where he is a major customer of the social enterprise. Indeed, some relationships which can potentially give rise to conflicts can be beneficial to the social enterprise. However, the social enterprise needs to recognise the risk that this board member may not act in the best interest of the social enterprise, or perceived by stakeholders to be not able to do so. This can affect the ability of the social enterprise to recruit other board members and also adversely affect the reputation of the social enterprise.

The key is to ensure that there are policies and procedures for board members and staff to disclose their interests and not to be personally involved in making decisions where they are conflicted. For example, where a supplier serves as a board member, he should declare to other board members that he is a supplier and he should not be involved in discussions and decisions involving selection of suppliers (where the board is involved in such decisions).

The social enterprise should also communicate such policies and procedures and do its utmost to ensure that they are complied with.

It is important to note that, under the law, a director (and in some cases, the CEO or equivalent who is not a director) owes fiduciary duties to the social enterprise and this requires him to disclose his interests and not to be involved in making decisions where he has a personal interest. Breaches may result in regulators or the social enterprise taking action against the director.

In order to protect the social enterprise, board members and staff, the social enterprise should have a conflict of interest policy which sets out the most common situations where conflicts may arise (such as those set out above) and the requirement for board members and staff to declare their interests and not to be involved in discussions and decisions where they have personal interest.

### 4.2 What are related party transactions?

Related party transactions are transactions between the social enterprise and those who potentially have a significant influence or control over the decision to undertake those transactions. Generally, related parties are (a) major shareholders, board members and key executives of the social enterprise, (b) close relatives of the major shareholders, board members and key executives of the social enterprise, and (c) organisations related to the social enterprise (such as a subsidiary) and those which are controlled by the major shareholders, board members and key executives of the social enterprise. Related party transactions are an important potential source of conflicts of interest for a social enterprise. While related party transactions are allowed and there may be business reasons for such transactions, they carry the risk of adversely affecting the performance of the social enterprise.

An example of a related party transaction is where the social enterprise buys IT equipment from an IT company owned by a board member. Such a transaction may actually be beneficial to the social enterprise as the IT equipment may be bought at a discounted price. However, it is also possible that the equipment is bought at an inflated price. It is therefore important that the board member discloses his interest in the transaction, does not participate in discussing the transaction and approving it, and the social enterprise ensures that price is competitive. The social enterprise should have policies in place to obtain quotes from other suppliers for similar products to ensure that the price is competitive, especially if the amount involved is significant.

<sup>18</sup> Most of these are based on the Code of Governance for Charities and Institutions of a Public Character, 2011.

Accounting standards (and in some cases, other rules) require that related party transactions be properly recorded and reported in the financial statements. Therefore, if during the course of the year, there have been business transactions between the social enterprise and a “related party”, these transactions will have to be tracked and reported in the financial statements. The accounting standard on related party transactions also requires the disclosure of compensation of key management personnel as a group, in total and for various categories of compensation. Where the financial statements have to be audited by an independent auditor, the auditor will also have to verify the reported amounts. Where the social enterprise is required to comply with accounting standards, the audit committee, or if there is no such committee, the board, should take steps to ensure that the amounts are properly reported

## 5 REMUNERATION AND PEOPLE MANAGEMENT

### 5.1 Should board members of social enterprises be paid and, if so, how can the appropriate amounts be determined?

It is acceptable for board members of social enterprise to be paid. Currently, for those social enterprises which are embedded within a charity, it is rare for board members of the charity to be paid. In those cases, the social enterprise side is generally not the main focus and, therefore, it is the charitable activities that determine the norm of not paying board members. Where a charity has a significant social enterprise, and in particular where it has established a separate business subsidiary and needs to attract individuals with significant business experience to serve on the board, there is a stronger case for paying board members.

However, whether there is payment of fees, and the level of these fees, are likely to be determined by factors such as the size and stage of development of the social enterprise, and whether the social enterprise is for-profit or not-for-profit. Potential board members are likely to base their expectations regarding payment of fees on these factors and also by whether they resonate with the social mission of the social enterprise. Where a social enterprise is for-profit and distributes dividends or surpluses to investors or members, board members, especially those who are recruited from outside the investors’ and members’ constituencies are likely to expect the payment of fees. However, they are likely to expect lower fees compared to other for-profit organisations. Therefore, board fees for social enterprises are more likely to be in the nature of honoraria rather than market-determined fees designed to adequately compensate board members for their responsibilities, contributions and time. The fees for for-profit organisations, which can be estimated from annual reports in the case of listed companies, can be used as a starting point for determining appropriate fee levels, with appropriate adjustments made for factors such as size and social enterprise status.

It is recommended that the Chairman should consult with the major investors (and grant-makers if applicable) and founders about the payment of board fees. The law or constitutive documents may require these fees to be approved by members.

### 5.2 How should senior management and staff of social enterprises be paid and how can the appropriate amounts be determined?

Where a social enterprise employs staff who are equally employable by other organisations, the pay levels of these staff must be reasonable in order for the social enterprise to be able to attract and retain talent. However, pay levels for social enterprises are likely to be more comparable to pay levels in not-for-profit organisations than organisations which are purely for-profit because of the social mission. This is especially so if the social enterprise is itself not-for-profit.

Where a social enterprise's mission involves providing employment opportunities to certain disadvantaged groups, it is important that the social enterprise is not seen to be exploitative. The social enterprise should also strive to ensure that surpluses generated are shared equitably amongst different stakeholders, including employees, or re-invested into the social enterprise, rather than solely distributed to investors in the social enterprise.

Like any other organisations, social enterprises need to be able to recognise and reward management and staff who perform well. Therefore, "pay for performance" has a place in social enterprises although the potential amount of performance-based pay relative to base salary is likely to be lower than for for-profit organisations. It is generally better for pay structures to be simple and transparent, and any benefits should be kept to a minimum (although a social enterprise may offer discounts to staff). Performance measures which are used as the basis for determining salary increments and bonuses should reflect both the "social" and "enterprise" aspects.

It is common for organisations to engage external consultants to undertake salary surveys to help them set pay levels. Social enterprises should bear in mind that such surveys may not cover organisations which are comparable and that salary data for social enterprises is likely to be sparse.

### **5.3 What formal processes or procedures should be used in developing remuneration policies and setting remuneration packages for board members, senior executives and employees?**

As mentioned earlier when discussing conflicts of interest, a fundamental principle is that no individual should determine his own pay. In the corporate world, senior management pay is generally set by the board of directors or by a remuneration or human resource committee made up of board members. The board or committee will usually also approve the overall remuneration philosophy (e.g., how competitive the organisation should be relative to other comparable organisations), the remuneration policies (e.g., the targeted mix of pay in terms of base salary, benefits and bonuses for management and other employees; types of incentives to use; key performance measures), actual salary packages for key executives, and salary ranges for different groups of employees. The salary increments and bonuses for lower-level employees is usually decided by management although the board or committee may be the final approval authority. The board or committee should at least assure itself that there is a fair and proper process for appraising employee performance and recognising and rewarding employees. The same considerations on the need to avoid conflicts of interest in determining remuneration, and having proper procedures for setting remuneration philosophy, remuneration policies, salary packages and ranges apply to a social enterprise, although a social enterprise may have less formal structures in place.

In terms of setting fees or honoraria for board members, this can be recommended by the remuneration or human resource committee and approved by the board. In some cases, the law or constitutive documents may require members to approve the total remuneration for all the board members.

### **5.4 If the social enterprise employs disadvantaged groups, how should it ensure these groups are treated fairly?**

Social enterprises often seek to help disadvantaged groups by employing them or by using their profits to benefit such groups. However, they can also be seen to be exploitative if there is a perception that most of the benefits of the social enterprise accrue to the founders, managers or investors. For example, a social enterprise may pay its employees unusually low salaries which may be little more than the daily transportation costs incurred by these employees. This can harm the reputation of the social enterprise and threaten its long-term sustainability. Lessons can be drawn from the cases of multinational companies paying employees in third-world countries wages which are high by local standards, but low by international standards. The negative perception is related to the fact that these companies sell their products at market prices and are profit-making. As Singapore does not have a minimum wage law, a social enterprise is in a position to pay token wage.

Where a social enterprise employs workers who come from disadvantaged groups, it should ensure that the employment terms and conditions are not too far removed from ordinary employees doing comparable work. Of course, factors such as lower productivity may justify lower pay and benefits, and the important thing is for the social enterprise to be able to justify significant discounts in pay and benefits. The social enterprise should also consider profit-sharing with its employees or ensure that most of the profits are reinvested back into the social enterprise.



## 6 FINANCIAL MANAGEMENT AND PERFORMANCE MONITORING

### 6.1 What kinds of budgets should a social enterprise prepare to ensure that it is financially well managed?

The most important budgets are an operating budget and a cash budget, prepared on annual basis, often with breakdowns into sub-periods, such as quarters. For a social enterprise with significant capital investment, it is useful to have a capital budget. For a social enterprise with significant manpower requirements, a separate manpower budget may also be useful.

### 6.2 How should the achievement of these budgets be monitored?

It is important to monitor the achievement of the budgets on an annual basis. It is also useful to monitor the achievement of the budgets periodically throughout the year – whether this is done on a monthly or less regular basis depends on the size and resources available.

### 6.3 What other aspects of performance should be monitored by senior management and the board?

The social enterprise needs to monitor and manage its performance beyond financial returns. It is particularly important that the social enterprise delivers on its social mission. The balanced scorecard approach, commonly used in for-profit organisations, may be particularly useful for social enterprises. For example, it has been proposed that the social enterprise can develop indicators and current (such as 18-month) and longer-term (such as 3-year) targets relating to its business model, organisational development, financial return and social return.<sup>19</sup> Social return indicators can include jobs created for beneficiaries, improvement in quality of life of beneficiaries, environmental or social impact, etc.

<sup>19</sup> Meadows, Maureen and Pike, Matthew (2010). Performance management for social enterprises. *Systemic Practice and Action Research*, 23(2), pp. 127–141. Meadows and Pike provide examples of indicators for different types of social enterprises, including a credit union development agency, a materials management organisation, and a business centre housing small businesses and community organisations.

## 7 RISK MANAGEMENT AND INTERNAL CONTROL

### 7.1 What are some of the key risks applicable to a social enterprise and how should a social enterprise manage these risks?

A suggested classification and examples of key risks are as follow:<sup>20</sup>

Weak organisational capacity:

- dependence on founder - e.g., sudden loss of founder without adequate succession
- lack of financial control – e.g., not meeting budgets
- lack of proper human resource systems – e.g., unable to attract good staff, loss of good staff, lack of incentives for staff to perform
- weak governance – e.g., unethical behaviour, fraud, legal liability

Poor financial performance

- lack of reserves
- inadequate capitalisation
- trading losses
- single or few streams of income

Poor service development

- lack of relevant, quality services
- lack of market intelligence/feedback
- inability to reach customers

Inability to provide evidence of added social value

- undermines social mission
- loss of support from stakeholders
- reputational damage

The essence of risk management is not risk avoidance as a social enterprise will have to take risks to achieve its social and financial goals. However, it needs to be aware of the key risks that can undermine the achievement of these goals and monitor and manage these risks.

Management of the social enterprise needs to identify the key risks, assess their potential impact on the performance and sustainability of the social enterprise, and take steps to monitor and manage these risks. Where there is a board of directors, management should

<sup>20</sup> Ibid. Adapted

also report to the board on the key risks and how they are managed. The board/senior management will need to decide on its risk appetite and risk tolerance - that is the levels of risk it is prepared to take and the acceptable level of variation around objectives. Clearly, the sophistication of the risk management approach adopted will depend on factors such as size of the social enterprise, the types of products or services it offers, and its available resources.

## **7.2 What are the key internal controls that a social enterprise should have in place?**

Internal controls can be broadly classified into financial, operational and compliance controls. Examples of financial controls include procurement procedures and controls; receipting, payment procedures and controls; and systems for the delegation of authority and approval limits.<sup>21</sup> Examples of operational controls include physical safeguards (such as cameras, locks or barriers to safeguard property); supervision or monitoring of operations; and IT controls (such as access rights, access logs; and use of passwords). Examples of compliance controls include code of conduct/ethics which spell out the importance of ethical behaviour and compliance with laws, rules, regulations and policies; checklists; and audits. Employee feedback and whistleblowing programmes are important tools for employees, customers, suppliers and other stakeholders to alert management and the board on breakdown of internal controls and legal and ethical violations.

## **7.3 Should the social enterprise form an audit committee? What kinds of expertise and background are most valuable for audit committee members?**

An audit committee is a common committee established by companies, not-for-profit organisations and public sector organisations. It is usually a subcommittee of the board and its main responsibilities are to help the board in overseeing financial reporting, internal controls and risk management, and internal and external audits. Although laws, listing rules or codes of governance generally require audit committee members to be board members, it is relatively common for audit committees in not-for-profit organisations to include non-board members. A social enterprise - whether one with or without a board - may find it useful to establish an audit committee to oversee the areas stated above.

It is important for the audit committee to have members who understand the business, and issues relating to accounting, internal control and audits. Therefore, it is widely accepted that the committee should have one or two individuals who have an accounting or relevant financial background.

## **7.4 Should the social enterprise have an internal audit function?**

An internal audit is useful for providing management and the board with reasonable assurance that internal controls are operating effectively and that key risks are adequately managed. It can also assist management in identifying potential improvements in operational efficiency.

However, an internal audit may not satisfy the cost-benefit test for small social enterprises or relatively simple businesses, even though small social enterprises may not be able to implement adequate checks and balances such as proper segregation of duties which may increase certain risks. The ability to more closely supervise activities may however mitigate these risks and compensate for the lack of an internal audit.

As a social enterprise grows, it becomes more important to have an internal audit function, either in-house or outsourced.

<sup>21</sup> Code of Governance for Charities and Institutions of a Public Character, 2011.

## 8 DISCLOSURE, TRANSPARENCY AND COMMUNICATION WITH STAKEHOLDERS

### 8.1 What are the requirements that the social enterprise has to comply with to fulfil its accountability to stakeholders?

Generally, statutory requirements dealing with accountability focus on accountability to specific stakeholders, in particular, members (who may be shareholders) and regulators. They cover issues such as filing of information with regulators, preparation of statutory accounts, audit of financial statements, compliance with accounting standards, seeking members' approval for certain matters, and holding of meetings with members. The requirements depend on the organisational form of the social enterprise, for example, whether it is private company, public company, a company limited by shares, a company limited by guarantee or a cooperative, and whether it is registered as a charity (where a social enterprise is part of a charity). The constitution (such as articles of association) may also contain requirements dealing with accountability to members.

It is important to have someone with the relevant knowledge and experience to advise and assist the social enterprise with compliance with these requirements. If it is company, the Companies Act requires the appointment of a company secretary with the requisite knowledge and experience. The company secretary plays an important role in ensuring compliance with statutory requirements and requirements in the constitution.

The Companies Act requires companies to prepare annual accounts which have to be adopted by members at a meeting held within 6 months after the end of the financial year. The accounts have to be sent to members at least 14 days before the meeting. A private company can dispense with holding annual general meetings if all members agree.

In addition to the accounts, a company must also present to members a directors' report and an auditor's report.<sup>22</sup> Currently, certain exempt private companies are not required to appoint an auditor if its annual turnover does not exceed \$5 million. This audit exemption is likely to be extended to other small private companies.<sup>23</sup>

If a social enterprise is a co-operative society, then it is subject to requirements in the Co-operative Societies Act, which contains requirements relating to annual report, accounts, audits and holding of meetings.

### 8.2 In addition to any statutory information, what kinds of information should the social enterprise disclose to discharge its accountability to stakeholders (e.g., members, shareholders, beneficiaries, grant-makers)?

The social enterprise should consider disclosing the following additional information:

- a) the social and/or environmental needs it meets;
- b) its specific social mission;
- c) the key products or services it sells to support its social mission;
- d) how it ensures that the social mission is achieved;
- e) how it is delivering on its declared social mission;
- f) how surpluses generated are reinvested or shared amongst key stakeholders such as beneficiaries, employees, investors and the community;
- g) how amounts upon withdrawal of investment would be determined;
- h) whether remaining assets, if the social enterprise ceases trading, would be used for social/environmental purposes;
- i) its constitution; and
- j) how it is governed, including details of its board of directors and key management, key board committees and key governance practices.

Other guidelines, such as those in applicable codes of governance, may also include recommended practices on communications with key stakeholders.

While certain information is required by legislation or recommended by codes to be disclosed in the annual report, such information and other additional information can also be made available on the social enterprise's website.

<sup>22</sup> The current review of the Companies Act includes a proposal to abolish the directors' report.

<sup>23</sup> The current review of the Companies Act proposes an audit exemption for private companies which fulfil two of the following criteria: (a) annual revenue of not more than \$10 million, (b) total gross assets of not more than \$10 million, (c) number of employees not more than 50.

## CHECKLIST ON KEY GOVERNANCE ISSUES FOR A SOCIAL ENTERPRISE

General Issues		Relevant Subsections in the Primer
1	Does the organisation deliver measurable social and/or environmental impact with equitable returns to their different stakeholders?	2.1
2	What is the model of the social enterprise - work integration, plough-back profit, subsidised services or social services? If not any of this, what is its model?	2.2
3	Is the social enterprise for-profit or not-for-profit? If it is for-profit, why is it considered a social enterprise and not a regular commercial business?	2.3
4	If the social enterprise is not-for-profit, what sets it apart from a charity?	2.4
5	If the social enterprise is part of a charity, does it comply with rules and guidelines applicable to charities?	2.5
6	Is the social enterprise set up as a sole proprietorship, partnership, co-operative, company limited by guarantee or company limited by shares? Have the pros and cons of different organisational forms been adequately considered?	2.6
7	Do those responsible for managing and governing the social enterprise understand the key attributes of good governance?	2.7
8	Has the social enterprise clearly identified the key stakeholders and ensured that the expectations to key stakeholders are understood and met?	2.9

Board of Directors		Relevant Subsections in the Primer
1	Is the social enterprise required to have a board of directors?	3.1
2	Should the social enterprise establish a board of directors or equivalent body even if it is not required to do so?	3.2
3	Should the social enterprise establish an advisory board?	3.2

### Board of Directors – For a Social Enterprise with a Board of Directors

1	Is the number of members on of the board of directors appropriate given the size and nature of operations of the social enterprise?	3.3
2	Do executives and employees of the social enterprise serve on the board? If so, have the pros and cons been adequately considered?	3.4
3	Are there non-executive directors on the board?	3.5
4	Do the directors understand their duties and responsibilities?	3.5
5	Was the Chairman of the board appointed through a proper process?	3.6

6	Is the Chairman effective?	3.6
7	Does the Chief Executive Officer (or equivalent such as Executive Director) chair the board? If so, are there safeguards for ensuring proper segregation of duties and proper oversight of management?	3.7
8	Do the directors have the right mix of experience and backgrounds and do they have essential personal traits that make them good directors?	3.8
9	Does the social enterprise have a process and strategy for appointing qualified directors?	3.8
10	Does the social enterprise understand the appropriate process for appointing directors?	3.8
11	Does the social enterprise provide adequate information to directors before and immediately after they joined the board?	3.9
12	Do directors keep abreast of important issues relevant to their role as directors and to the social enterprise, for example, through professional development programmes?	3.10
13	Are directors of a social enterprise given support for attending relevant professional development programmes?	3.10
14	Are directors contributing effectively to board decisions and to the performance of the social enterprise?	3.11
15	Has the social enterprise clearly distinguished the roles and responsibilities of the board and management?	3.12
16	Is the board spending most its time on decisions that fall within its role and responsibilities?	3.12
17	Is the involvement of the board in the setting of the mission, vision and core values and the development of the long-term strategies, goals, action plans and budgets appropriate?	3.13
18	Does the board oversee the implementation of strategies and the achievement of goals, action plans and meeting of budgets?	3.14
19	Has the board formed committees to help it in its work, and if not, has it carefully considered whether it should do so?	3.15
20	Are board committees established appropriate for the social enterprise and was it done through a proper process?	3.15
21	Does the board delegate decisions to committees and management and, if so, has it ensured that it is still able to fulfil its ultimate responsibility for these decisions?	3.16
22	Does the board meet often enough?	3.17
23	Does the board adequately plan its meetings?	3.17

<b>Board of Directors – For a Social Enterprise with a Board of Directors</b>		
24	Are both the Chairman and CEO involved in the planning for the agenda of board meetings?	3.18
25	Does the Chairman conduct board meetings effectively to ensure that they make full use of the time and expertise of the directors?	3.19
26	Is the process for making decisions outside of formal board meetings in accordance with any constitutive documents (such as articles of association) that may apply?	3.20
27	Is the information provided to the board on a regular basis and at board meetings adequate to help the board discharge its responsibilities?	3.21
28	Does the board have a process (such as a board assessment) or plan for improving its effectiveness?	3.22

<b>Financial Management and Performance Monitoring</b>		Relevant Subsections in the Primer
1	Are budgets prepared and are they adequate to help ensure that the social enterprise is financially well managed?	6.1
2	Is the achievement of these budgets monitored?	6.2
3	Are other important aspects of performance, such as jobs created for the beneficiaries, monitored by senior management and the board?	6.3

<b>Conflict of Interest</b>		Relevant Subsections in the Primer
1	Are there conflicts of interests involving board members, management or staff and, if so, how are they managed?	4.1
2	Are there related party transactions that have to be reported in the financial statements and are they properly recorded and reported?	4.2

<b>Risk Management and Internal Control</b>		Relevant Subsections in the Primer
1	Have the key risks applicable to the social enterprise being identified and are these risks monitored and managed?	7.1
2	Are there internal controls over critical areas of operations to help safeguard the assets and protect the reputation of the social enterprise?	7.2
3	Does the social enterprise have an audit committee? If not, has it considered whether it should establish one?	7.3
4	If the social enterprise has an audit committee, do the members of the committee have the necessary expertise and background?	7.3
5	Does the social enterprise have an internal audit function (whether in-house or outsourced) and if not, has it considered whether it should have one?	7.4

<b>Remuneration and People Management</b>		Relevant Subsections in the Primer
1	Are board members of social enterprises paid and, if so, how are the amounts determined?	5.1
2	How are senior management and staff of social enterprises paid, and how are the amounts determined?	5.2
3	Are there formal processes or procedures used in developing remuneration policies and setting remuneration packages for board members, senior executives and employees?	5.3
4	If the social enterprise employs disadvantaged groups, how does it ensure these groups are treated fairly?	5.4

<b>Disclosure, Transparency and Communication with Stakeholders</b>		Relevant Subsections in the Primer
1	Has the social enterprise complied with mandatory requirements to fulfil its accountability to stakeholders?	8.1
2	In addition to any statutory information, is the information disclosed by the social enterprise to stakeholders adequate?	8.2

## ABOUT THE AUTHOR

Mak Yuen Teen is Associate Professor of Accounting at the NUS Business School, National University of Singapore. He holds First Class Honours, Masters and PhD degrees in accounting and finance and is a fellow of CPA Australia.

Prof Mak is Chairman on a large charity with a social enterprise arm and recently retired as Deputy Chairman from another charity. He has served on the audit advisory committee of the United Nations Population Fund based in New York since 2006. He was a member of the Corporate Governance Committee which released Singapore's first Code of Corporate Governance for listed companies in 2001 and a member of the Council on Corporate Disclosure and Governance (CCDG) which revised the Code in 2005. He is also a member of the Charity Council in Singapore and chaired the subcommittee which developed and refined the Code of Governance for Charities and IPCs. Prof Mak is also a member of the OECD Asian Corporate Governance Roundtable.

Prof Mak's report on improving the implementation of corporate governance practices in Singapore, commissioned by the Monetary Authority of Singapore and the Singapore Exchange, was published in 2007 and several of his recommendations had been implemented. His book called "From Conformance to Performance: Best Corporate Governance Practices in Asia" was published by McGraw-Hill in 2005.

Prof Mak developed the Governance and Transparency Index, which rates the corporate governance of listed companies in Singapore. He is currently involved in an initiative by the ASEAN regulators to develop an ASEAN corporate governance ranking.

Prof Mak is a regular speaker at corporate governance conferences for directors, regulators, executives and industry professionals and a regular commentator on accounting and corporate governance issues in the local and international media.

## ABOUT SOCIAL ENTERPRISE ASSOCIATION

The Social Enterprise Association (SEA) is an umbrella organisation that promotes social entrepreneurship in Singapore so as to bring about positive social impact and vibrant, thriving community life. It seeks to build up a base of members comprising of social enterprises, social entrepreneurs, caring companies and other organisations that feel they have a stake in developing this sector.

Specifically, it is established to do the following:

1. Foster a culture of social entrepreneurship;
2. Support social enterprises and social entrepreneurs through active partnerships with private and public sectors;
3. Build up the institutional capacity of social enterprises through the Social Enterprise Development Centre (SEDC);
4. Create awareness of financing options for social enterprises; and,
5. Develop and promote best practices for social enterprises.

SEA aims first and foremost to address the needs and interests of its target community – social enterprises, social entrepreneurs and would-be social innovators. In that way, it will create a platform for potential partners from private sector and government who are interested to work with the social enterprise community, to come forward to form synergistic partnerships with SEA and its members.

SEA runs a training and business consultancy programme called Social Enterprise Development Centre or SEDC which works with its social enterprise members to improve their institutional capacities.